

Message Text

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FM USMISSION OECD PARIS

TO SECSTATE WASHDC IMMEDIATE 9062

LIMITED OFFICIAL USE SECTION 1 OF 2 OECD PARIS 6539

E. O. 11652: N/ A

TAGS: EFIN, US

SUBJECT: UNDER SECRETARY VOLCKER'S REVISED MOV TESTIMONY

FOR TREASURY OPENING OF BUSINESS MARCH 16

INFORM MICHAEL BRADFIELD IMMEDIATELY UPON RECEIPT

1. VOLCKER HAS REVIEWED AND CHANGED DRAFT. YOU MAY CUT FURTHER IF FEASIBLE. ARRANGE EARLY MONDAY AM REPRODUCTION. HAVE TEXT AVAILABLE FOR VOLCKER SATURDAY. ARRANGE STANDBY SECRETARY SUNDAY.

2. FOLLOWING IS TEXT INCORPORATING VOLCKER'S CHANGES. PRECEDING PARAGRAPHS REMAIN UNCHANGED.

BEGIN TEXT :

IMF SUBSCRIPTION AND PAID- IN CAPITAL SUBSCRIPTIONS

THE DEVALUATION ALSO HAS THE EFFECT OF INCREASING THE VALUE OF ANOTHER TYPE OF ASSET -- OUR PAID - IN SUBSCRIPTIONS TO THE INTERNATIONAL MONETARY FUND AND THE INTERNATIONAL DEVELOPMENT LENDING INSTITUTIONS. THESE ASSETS ARE DENOMINATED IN TERMS OF GOLD AND THERE FORE INCREASE IN DOLLAR VALUE -- \$ 606 MILLION FOR THE FUND SUBSCRIPTION AND \$ 477 MILLION FOR THE PAID- IN CAPITAL SUBSCRIPTIONS TO THE LENDING INSTITUTIONS. HOWEVER, TO REALIZE THIS INCREASE IN VALUE, WE MUST PAY IN ADDITIONAL DOLLARS TO THESE INSTITUTIONS, WHICH I WILL MENTION IN THE LIMITED OFFICIAL USE

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DISCUSSION OF THE INCREASE IN OUR LIABILITIES.

THE TOTAL INCREASE IN ASSETS AMOUNTS TO \$2.5 BILLION
-- \$1.4 BILLION IN LIQUID INTERNATIONAL RESERVE ASSETS
AND \$1.1 BILLION IN THE VALUE OF INTERNATIONAL FINANCIAL
INSTITUTIONS SUBSCRIPTIONS.

INCREASE IN LIABILITIES

ON THE LIABILITY SIDE, THERE ARE INCREASES IN THREE
GENERAL TYPES OF LIABILITIES:

-- LIABILITIES RESULTING FROM BORROWING OF FOREIGN
CURRENCIES AND FOREIGN EXCHANGE OPERATIONS;

-- INCREASE IN REPAYMENT OBLIGATIONS RESULTING FROM
IMF DRAWINGS AND SDR ALLOCATIONS; AND

-- MAINTENANCE OF VALUE OBLIGATIONS IN THE
INTERNATIONAL FINANCIAL INSTITUTIONS.

SOME OF THESE LIABILITIES WILL BE FINANCED FROM FEDERAL
RESERVE RESOURCES AND FROM THE EXCHANGE STABILIZATION
FUND WITHOUT NEED OF APPROPRIATIONS. THE REMAINDER --
OUR INCREASED PAYMENT OBLIGATIONS TO THE INTERNATIONAL
FINANCIAL INSTITUTIONS -- WILL REQUIRE AN APPROPRIATION
OF UP TO \$2.3 BILLION. HOWEVER, OF THIS NEW
OBLIGATIONAL AUTHORITY, ONLY \$477 MILLION WILL RESULT
IN BUDGETARY EXPENDITURES. I WOULD NOW LIKE TO GIVE
YOU SOME OF THE DETAILS ON EACH OF THESE LIABILITY
ITEMS.

NON- APPROPRIATION LIABILITIES -- TREASURY BORROWINGS,
SDR AND SWAPS

THE PORTIONS OF OUR LIABILITIES NOT REQUIRING APPROPRIATIONS
ARE THOSE DERIVED FROM TREASURY BORROWING IN FOREIGN
CURRENCIES, FROM SPECIAL DRAWING RIGHTS AND FROM
FEDERAL RESERVE MUTUAL CREDIT " SWAP" ARRANGEMENTS.

THE DEVALUATION WILL MAKE IT MORE COSTLY IN
TERMS OF DOLLARS TO PURCHASE THE FOREIGN CURRENCIES
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NEEDED TO REPAY THE \$1,714 MILLION OF TREASURY BORROWING

DENOMINATED IN SWISS FRANCS AND GERMAN MARKS. THE ADDITIONAL COST IS ESTIMATED AT \$193 MILLION AND WOULD BE FINANCED FROM THE EXCHANGE STABILIZATION FUND -- THE ORGAN OF THE GOVERNMENT ESTABLISHED FOR DEALING IN FOREIGN EXCHANGE AND WHICH IS DESIGNED TO ABSORB GAINS OR LOSSES INVOLVED IN FOREIGN EXCHANGE TRANSACTIONS.

SIMILARLY, OUR INCREASED REPAYMENT OBLIGATIONS TO THE IMF ON ALLOCATIONS OF SPECIAL DRAWING RIGHTS DO NOT REQUIRE AN APPROPRIATION. IN ACCORDANCE WITH ESTABLISHED ACCOUNTING PROCEDURES, WE HAVE NOT ONLY WRITTEN UP BY \$218 MILLION THE INCREASE IN VALUE OF OUR PRESENT HOLDINGS OF SDR AS AN ASSET, AS I HAVE ALREADY DESCRIBED, BUT WE HAVE ALSO INCREASED ON THE BOOKS OF THE ESF OUR LIABILITY TO THE INTERNATIONAL MONETARY FUND OF \$278 MILLION BASED ON OUR ALLOCATIONS OF SPECIAL DRAWING RIGHTS. THE NET LIABILITY, AMOUNTING TO \$60 MILLION, WOULD ONLY BE REALIZED IF THE SDR SCHEME WERE LIQUIDATED OR IF THE UNITED STATES WITHDREW FROM IT.

THE LAST NON- APPROPRIATION LIABILITY RESULTS FROM THE ADDITIONAL COST OF PURCHASING FOREIGN CURRENCIES AT THE NEW EXCHANGE RATES TO REPAY FEDERAL RESERVE SWAP BORROWING TALLING \$1,639 MILLION. THE ADDITIONAL COST TO THE FEDERAL RESERVE OF PURCHASING FOREIGN CURRENCIES IS AN ESTIMATED \$196 MILLION AND THIS AMOUNT WILL BE ABSORBED FROM THE EARNINGS OF THE FEDERAL RESERVE SYSTEM.

LIABILITIES REQUIRING APPROPRIATIONS

I WILL NOW TURN TO THE LIABILITIES REQUIRING APPROPRIATIONS.

THESE, TOO, ARE OF THREE DIFFERENT TYPES:

-- MAINTENANCE OF VALUE ON THE INTERNATIONAL MONETARY FUND'S HOLDINGS OF DOLLARS;

-- CONTINGENT OBLIGATIONS TO THE INTERNATIONAL LIMITED OFFICIAL USE

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DEVELOPMENT LENDING INSTITUTIONS; AND

-- PAID- IN CAPITAL SUBSCRIPTIONS TO THESE INSTITUTIONS.

AS YOU CAN SEE, ALL OF THESE LIABILITIES ARE TO THE

INTERNATIONAL FINANCIAL INSTITUTIONS. THEY DERIVE FROM A PROVISION IN THEIR ARTICLES OF AGREEMENT REQUIRING MEMBER COUNTRIES TO MAINTAIN THE VALUE OF THEIR SUBSCRIPTIONS IN TERMS OF A COMMON DENOMINATOR, IN THIS CASE GOLD. IN OTHER WORDS, A MEMBER THAT DEVALUES ITS CURRENCY MUST PAY IN ADDITIONAL AMOUNTS OF THAT CURRENCY IN ORDER TO MAINTAIN THE SAME GOLD VALUE, AND THUS THE SAME PROPORTIONATE CONTRIBUTIONS, AS EXISTED PRIOR TO DEVALUATION. THE PROVISION IS THUS INTENDED TO GUARD AGAINST LOSS IN THE RELATIVE VALUE OF THE CONTRIBUTIONS OF ALL MEMBERS DESPITE ALTERATIONS IN EXCHANGE RATES, THUS ASSURING THAT THE EQUITABLE BURDEN SHARING THAT THESE INSTITUTIONS SEEK TO ACHIEVE IS NOT DISTORTED AND THAT VOTING RIGHTS ARE NOT DIMINISHED. IN THE PAST, THERE HAVE BEEN OVER 200 DEVALUATIONS INVOLVING 60 COUNTRIES. IN EVERY CASE, MAINTENANCE OF VALUE OBLIGATIONS HAVE BEEN FULFILLED.

LIABILITY TO IMF

THE FIRST TYPE OF LIABILITY -- MAINTENANCE OF VALUE ON INTERNATIONAL MONETARY FUND HOLDINGS OF DOLLARS -- HAS TWO COMPONENTS. FIRST, THE IMF ARTICLES REQUIRE US TO INCREASE THE VALUE OF OUR SUBSCRIPTION OF \$7.2 BILLION BY 11.1 PERCENT. IN ADDITION, THE UNITED STATES HAS PAID \$1.4 BILLION TO THE FUND AS A RESULT OF DRAWINGS OF FOREIGN CURRENCIES. THIS SUM MUST ALSO BE MAINTAINED IN VALUE BY THE SAME PERCENTAGE RESULTING IN A PAYMENT OF \$150 MILLION.

THUS, TOTAL PAYMENTS TO THE FUND WILL AMOUNT TO \$756 MILLION. THIS OBLIGATION -- TO BE REFLECTED IN THE FORM OF A LETTER OF CREDIT -- WILL HAVE NO BUDGETARY IMPACT. U. S. TRANSACTIONS WITH THE FUND ARE EXCLUDED FROM THE BUDGET IN ACCORDANCE WITH A RECOMMENDATION OF

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THE PRESIDENT'S COMMISSION ON BUDGET CONCEPTS WHICH POINTED OUT THAT SUBSCRIPTIONS, DRAWINGS AND OTHER TRANSACTIONS WITH THE FUND WERE MONETARY EXCHANGES OF ASSETS. OUR SUBSCRIPTION IS AKIN TO A DEPOSIT IN A BANK THAT CAN BE USED BY THE BANK FOR LENDING TO OTHERS AND ALSO TO ESTABLISH A LINE OF CREDIT FOR THE DEPOSITOR -- IN THIS CASE THE UNITED STATES.

CONTINGENT OBLIGATIONS TO DEVELOPMENT BANKS

THE SECOND CATEGORY INVOLVES CONTINGENT OBLIGATIONS AMOUNTING TO \$992 MILLION. THE LARGEST PART OF THIS AMOUNT -- \$920 MILLION -- DERIVES FROM THE UNITED STATES SUBSCRIPTIONS TO THE CALLABLE CAPITAL OF THE WORLD BANK, THE INTER- AMERICAN DEVELOPMENT BANK, AND THE ASIAN DEVELOPMENT BANK. THIS CALLABLE SUBSCRIPTION, TOGETHER WITH THE SIMILAR SUBSCRIPTIONS OF OTHER MEMBERS, STANDS AS A GUARANTEE BEHIND THE BANKS' BORROWING IN PRIVATE CAPITAL MARKETS AND IS TO BE CALLED ONLY IF THESE BANKS CANNOT MEET THEIR OBLIGATIONS TO BONDHOLDERS.

THE OTHER ELEMENT OF CONTINGENT OBLIGATION, AMOUNTING TO \$72 MILLION, INVOLVES LOANS MADE IN DOLLARS BY THE FUND FOR SPECIAL OPERATIONS OF THE INTER- AMERICAN DEVELOPMENT BANK BUT REPAYABLE IN DOLLARS OR LOCAL CURRENCIES. THE U. S. WILL HAVE TO MAINTAIN THE VALUE OF THE LOAN REPAYMENTS ONLY IF MADE IN DOLLARS -- A HIGHLY UNLIKELY EVENT.

I MUST EMPHASIZE THE REMOTE NATURE OF THESE CONTINGENT
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LIABILITIES. OUR CALLABLE CAPITAL OBLIGATIONS HAVE NEVER, AS YET, BEEN CALLED AND WE DO NOT EXPECT CALLS IN THE FUTURE. WE CAN MAKE THIS PREDICTION BASED ON THE SOUND FINANCIAL CONDITION OF THESE INSTITUTIONS, THEIR RESERVES, AND THE FACT THAT THIS GUARANTEE IS BACKED NOT ONLY BY THE UNITED STATES BUT BY OTHER MAJOR COUNTRIES AS WELL.

THUS, WE DO NOT ANTICIPATE THAT THESE LIABILITIES -- WHILE CONSTITUTING A CONTINGENT CALL UPON U. S. GOVERNMENT RESOURCES ANALOGOUS TO OTHER GOVERNMENT GUARANTEES -- WILL MATERIALIZE.

PAID- IN CAPITAL

THE THIRD CATEGORY OF OBLIGATIONS INVOLVES PAID- IN CAPITAL SUBSCRIPTIONS. THIS WILL INVOLVE \$477 MILLION FLOWING FROM CERTAIN PRESENT AND PLANNED FUTURE CONTRIBUTIONS TO THE THREE BANKS MENTIONED ABOVE, PLUS THE INTERNATIONAL DEVELOPMENT ASSOCIATION.

IT IS ONLY THIS \$477 MILLION THAT WILL RESULT IN BUDGETARY EXPENDITURES. THERE WILL BE NO EXPENDITURES IN FISCAL YEAR 1973 AND \$12 MILLION IN FISCAL YEAR 1974. THE REMAINING AMOUNTS WILL BE SPREAD OUT EVENLY OVER ABOUT 10 YEARS WITH EXPENDITURES OF ABOUT \$40 MILLION PER YEAR.

THE TOTAL AMOUNT OF OBLIGATIONS REQUIRING APPROPRIATION RESULTING FROM THE PAR VALUE CHANGE NOW BEFORE YOU AMOUNTS TO \$2,225 MILLION CONSISTING OF (A) OBLIGATIONS -- TO THE IMF -- \$756 MILLION; (B) CONTINGENT OBLIGATIONS -- \$992 MILLION; AND (C) PAID- IN CAPITAL SUBSCRIPTIONS -- \$477 MILLION. OUR APPROPRIATION REQUEST HAS BEEN ROUNDED TO A MAXIMUM OF \$2.3 BILLION BECAUSE WE CANNOT BE PRECISELY CERTAIN NOW OF THE EXACT AMOUNTS INVOLVED BECAUSE MAINTENANCE OF VALUE IS FIXED ONLY AT THE TIME THAT THE UNITED STATES COMMUNICATES ITS FORMAL PAR VALUE CHANGE TO THE INTERNATIONAL MONETARY FUND. IT IS MY HOPE, IN FACT, THE OBLIGATIONS WILL BE LESS THAN \$2,225 MILLION. THIS IS BORNE OUT BY OUR EXPERIENCE WITH THE 1972 APPROPRIATION WHICH, WHEN LIMITED OFFICIAL USE

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THE FINAL DATA WERE COMPILED, INVOLVED OBLIGATIONS OF \$1,578 MILLION AGAINST A ROUNDED APPROPRIATION OF UP TO \$1.6 BILLION.

AS THIS SUMMARY SUGGESTS, THERE IS A ROUGH OFFSTTTING BETWEEN INCREASES IN ASSETS AND LIABILITIES AS A CONSEQUENCE OF DEVALUATION. MOST OF THE LIABILITIES INVOLVE EITHER EXCHANGES OF ASSETS WITH THE IMF OR REMOTE CONTINGENT LIABILITIES.

THE INCREASE IN VALUE OF LIQUID INTERNATIONAL RESERVE ASSETS TALLING \$1.4 BILLION -- WHICH PROVIDES CASH TO THE TREASURY -- IS ALMOST THREE TIMES AS LARGE AS THE LIABILITIES ON PAID- IN CAPITAL TO THE INTERNATIONAL FINANCIAL INSTITUTIONS OF \$477 MILLION -- WHICH WILL EVENTUALLY BECOME A CASH DRAIN. MOREOVER, THE BUDGETARY IMPACT OF THOSE INCREASED LIABILITIES IS SPREAD OUT OVER A LONG PERIOD OF TIME.

I WOULD END BY STRESSING THAT MAINTENANCE OF VALUE IS
A LEGAL OBLIGATION FLOWING FROM THE DEVALUATION AND
OUR MEMBERSHIP IN THE INTERNATIONAL FINANCIAL INSTITUTIONS.
I STRONGLY FEEL THAT THIS OBLIGATION SHOULD BE MET IN
TIMELY FASHION AS IT HAS BEEN HONORED BY OTHER COUNTRIES.
THE AMOUNTS INVOLVED ARE QUITE SUBSTANTIAL. HOWEVER,
THE OUTLINE I HAVE GIVEN YOU TODAY MAKES IT CLEAR
THAT OUR APPROPRIATION REQUEST CANNOT BE LOOKED AT
IN ISOLATION BUT AS PART OF A PATTERN OF INCREASES
AND ASSETS AND LIABILITIES THAT ARE THE DIRECT
CONSEQUENCES OF THE CHANGE IN PAR VALUE THAT WE HAVE
RECOMMENDED TO THE CONGRESS. END TEXT.
BROWN

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